No. 11000

In the United States Circuit Court of Appeals

For the Ninth Circuit

RUBY M. BROWN,
Appellant,

vs.

NEW YORK LIFE INSURANCE COMPANY,
Defendant,

FEDERAL DEPOSIT INSURANCE CORPORATION,
Appellee.

Brief of Appellant

Upon Appeal from the District Court of the United States for the District of Oregon.

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Brief of Appellant

Upon Appeal from the District Court of the United States, for the District of Oregon

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JURISDICTIONAL STATEMENT

Appellant, a citizen of Oregon, brought this action against Defendant New York Life Insurance Company, a New York corporation, upon two checks issued to her by it, aggregating $20,582.00, payment of which was refused by the bank on which they were drawn.

By way of answer and cross complaint, Defendant

New York Life Insurance Company set up that the checks which it had issued to Appellant were in payment of the proceeds of two policies of life insurance issued by it to Edward N. Brown, in which Appellant was named beneficiary. After the issuance of the checks, Appellee, Federal Deposit Insurance Corporation (hereinafter called F.D.I.C.), notified the Defendant New York Life Insurance Company that it had information indicating that the money used to pay the premiums on the policies were funds of the Harney County National Bank of Burns, Burns, Oregon (hereinafter called the Bank). Defendant New York Life Insurance Company disclaimed any right or interest in or to the proceeds of the policies, paid the same into the registry of the Court and prayed that F.D.I.C. be made a party so that the claims of Appellant and F.D.I.C. to the proceeds of the policies might be determined.

After a pretrial conference, the Defendant New York Life Insurance Company was discharged from further liability and a trial was had upon the issues joined between Appellant and F.D.I.C., which resulted in the judgment which is the subject of this appeal.

Following the entry of judgment, Appellant filed a Motion for New Trial, which the court denied.

The action was properly filed in the District Court pursuant to Section 24 of the Judicial Code, as amended, (28 U.S.C.A., Section 41, subd. (1)).

Defendant New York Life Insurance Company was entitled to deposit the proceeds of the policies and to re-

quire Appellant and F.D.I.C. to litigate their claims to the fund under Section 24 of the Judicial Code, as amended, (28 U.S.C.A., Section 41, subd. (26)).

This appeal is taken from the judgment entered in the trial court and from the order denying Appellant's Motion for New Trial.

This court has jurisdiction of the appeal by virtue of Section 128 of the Judicial Code (28 U.S.C.A., Section 225), it being an appeal from final orders of the District Court, a direct review of which may not be had in the Supreme Court of the United States under Section 238 of the Judicial Code (28 U.S.C.A., Section 345).

STATEMENT OF THE CASE

The case was tried in the District Court upon an Agreed Statement of Facts, which is contained in the Pretrial Order.[1]

From the Agreed Statement, it appears that Appellant's son, Edward N. Brown, became connected with the Harney County National Bank of Burns, at Burns, Oregon, as a teller in 1927. He became assistant cashier on January 12, 1932.[2]

On November 27, 1935, he applied for and New York Life Insurance Company issued the policies of life insurance involved.[3]

On January 7, 1936, Brown was elected a Director of the Bank and on January 11, 1938, he was promoted to Vice President.[4]

Brown committed suicide on August 6, 1942, while the National Bank Examiners were making an examination of the Bank.[5] It was later found that he was short about $416,000.00.[6]

Brown paid all but one of the premiums on the policies by checks drawn on his accounts in the Bank. It was impossible to determine upon what bank the check in payment of the last premium was drawn.[7]

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1 R. 2-24.
2 R. 15.
3 R. 3.
4 R. 15.
5 R. 16.
6 R. 16 and 17.
7 R. 5 and 6.

Due proof of death of Brown was furnished to and received by New York Life Insurance Company and, by reason thereof, there became due and payable to Appellant, the beneficiary, the sum of $20,582.00.[8]

On or about August 18, 1942, New York Life Insurance Company issued and on August 21, 1942, it delivered to Appellant two checks whereby it directed the United States National Bank of Portland (Oregon) to pay to the order of Appellant the sum of $20,582.00.[9]

Appellant presented the checks to the United States National Bank for payment on September 4, 1942, and it failed and refused to pay Appellant any sum thereon and advised her that New York Life Insurance Company had previously countermanded payment thereof.[10].

Prior to September 4, 1942, when Appellant presented the checks for payment, F.D.I.C. had notified the New York Life Insurance Company that it had information indicating that the money used to pay the premiums on the policies were funds of the Harney County National Bank. This notification prompted the New York Life Insurance Company to stop payment on the checks.[11]

The balances in Brown's accounts at the time his checks in payment of the premiums were cleared through the Bank and the credits to his accounts which made up the various balances are all agreed upon.[12]

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8 R. 4.
9 R. 4.
10 R. 4.
11 R. 4 and 5.
12 R. 5-14.

The question of fact and issues of law which were to be determined by the trial court are clearly defined in the Pretrial Order.[13]

The cause was submitted on August 13, 1943, and briefs were then filed. On June 12, 1944, the court's decision was announced and on July 12, 1944, the opinion was filed.[14] Findings, Conclusions and Judgment were entered November 20, 1944.[15]

On November 28, 1944, Appellant filed her Motion for New Trial.[16] The Motion was argued January 8, 1945, and the Order Denying the Motion was entered January 31, 1945.[17]

Notice of Appeal from the Judgment and from the Order denying Appellant's Motion for New Trial was duly filed February 13, 1945.[18]

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13 R. 25-28.
14 R. 32-53.
15 R. 54-68.
16 R. 68-71.
17 R. 77.
18 R. 78.

SPECIFICATION OF ERROR I

THE TRIAL COURT ERRED IN CONCLUDING THAT F.D.I.C. SUCCEEDED TO OR BECAME SUBROGATED TO THE RIGHTS, IF ANY, OF THE HARNEY COUNTY NATIONAL BANK AGAINST THE PROCEEDS OF THE POLICIES.

(a) When F.D.I.C. made good the shortages in the depositors' accounts, the right of the Bank or of its depositors to pursue the claim against Brown's insurance was destroyed, otherwise a dual recovery would be permitted.

(b) After payment by F.D.I.C., there was in existence no enforceable claim against the insurance proceeds which the Bank could assign to F.D.I.C. and which would support a recovery in favor of F.D.I.C.

(c) F.D.I.C. has no right of subrogation.

(d) The assignment to it of the assets of the Bank or of the depositors' claims cannot assist it.

ARGUMENT

We contended in the trial court and we still insist that there is at the threshold an insuperable obstacle which defeats F.D.I.C.'s claim to the proceeds of the insurance policies.

The question is raised by the first Issue of Law contained in the Pretrial Order.[19] It is as follows:

> **"Whether Federal Deposit Insurance Corporation succeeded to or became subrogated to the Bank's rights, if any, as against the proceeds of the insurance policies upon the life of Edward N. Brown."**

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[19] R. 26.

F.D.I.C., as its name implies, is a Government owned insurance company, engaged in the business of guaranteeing depositors' accounts in banks which pay to it annually a premium equal to 1/12 of 1% of the total deposit liability.[20]

It is admitted in this case that the Harney County National Bank had paid the necessary assessments or premiums so that its depositors' accounts were insured by the F.D.I.C.[21]

It is also conceded that F.D.I.C. made good the shortages which were discovered in the accounts of the depositors of the Harney County National Bank after Brown committed suicide.[22]

Appellant's contention that F.D.I.C. is in no position to assert the rights which might have been available to the depositors or the Bank except for its responding upon its obligation to make good the shortages in the depositors' accounts is founded upon the case of *American Surety Co. v. Bank of California,* 44 F. Supp. 81; affirmed 133 F. (2d) 160.

In that case Crowe wrongfully abstracted money from Interior's account at the Bank of California under such circumstances that the Bank was liable to Interior for its loss. Interior had a policy of insurance with American Surety Co. protecting it against Crowe's infidelity and it made a claim under the policy and the loss was made

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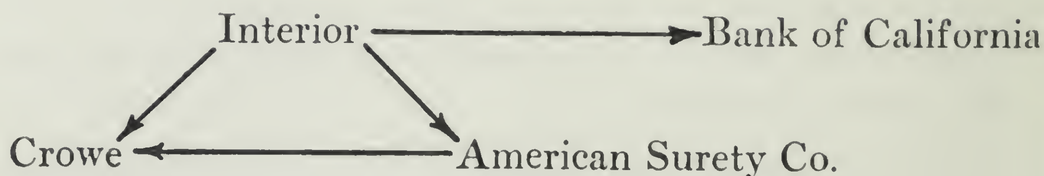
20 12 U. S. C. A., § 264 (1).
21 R. 16.
22 R. 14.

good. American Surety Co. took an assignment of Interior's claim against the Bank and attempted to recover on it against the Bank.

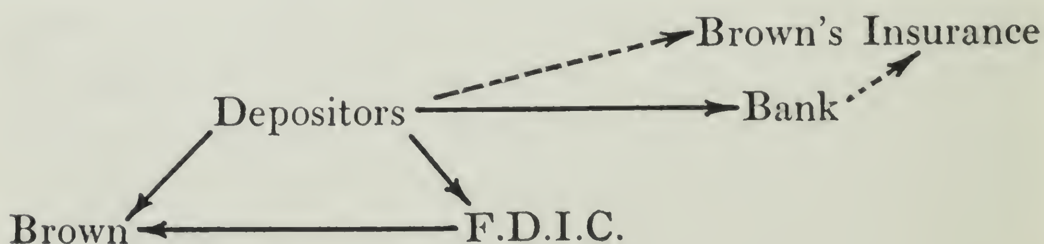
It was held that in responding on its policy the American Surety Co. merely did what it undertook to do for a consideration and therefore its payment discharged the debt and it could not aid its position or change the consequences by taking an assignment or anything else.

In our case here, it is claimed that Brown wrongfully abstracted money from depositors' accounts in the Harney County National Bank under such circumstances that the Bank was liable for the losses. F.D.I.C. had insured the depositors' accounts and it responded and has made good the shortages in the depositors' accounts, taking an assignment of the depositors' claims against the Bank. In this action F.D.I.C. is attempting to assert the remedy which the depositors and the Bank had to reach the proceeds of the policies on the life of the wrongdoer, and under the doctrine of the *American Surety Co.* case it must be held that when F.D.I.C. made good the shortages in the depositors' account that it merely did what it undertook to do for a consideration and therefore its payment discharged the debt and it can not aid its position or change the consequences by taking an assignment or anything else.

A diagram best demonstrates the applicability of the rule of the *American Surety Co.* case to the facts of this case.



Crowe, whose fidelity was insured by Interior with American Surety, wrongfully abstracted money from Interior's account under circumstances making the Bank of California liable for the loss. Interior therefore had a claim for its loss against Crowe, American Surety and the Bank. It called on the Surety Company to respond and it did so, taking an assignment of Interior's claim against the Bank. *Held* payment by the insurer extinguished the debt and it could not recover over against the Bank either by virtue of the assignment or subrogation.



Brown wrongfully abstracted money from depositors' accounts which were insured by F.D.I.C. under circumstances making the Bank liable for the loss. Depositors therefore had a claim against Brown, F.D.I.C. and the Bank. Depositors called upon F.D.I.C. to respond and it did so, taking an assignment of depositors' claims against the Bank. It must be held that payment by the insurer extinguished the debt so that it does not hold by reason of

assignment or subrogation any rights which the depositors or the Bank might have had over against Brown's Insurance but for its payment of the claims.

In the trial court, F.D.I.C.'s counsel argued that the *American Surety Co.* case was not applicable because:

1. F.D.I.C. was the owner by assignment of the Bank's claim against the insurance,
2. F.D.I.C. was seeking to enforce a property right assigned to it by the Bank,
3. If F.D.I.C. claimed by reason of subrogation, Appellant was no better off than her son—the wrongdoer,
4. As subrogee it had a right to recover the Bank's property as against Appellant, who paid nothing to become the beneficiary,
5. Edward N. Brown was the wrongdoer and Appellant claimed only through him.

Not one of the five reasons assigned is adequate by itself or in combination with any or all of the others to distinguish the case.

F.D.I.C. says it is the owner by assignment of the Bank's claim (Reasons 1 and 2 above). However, the F.D.I.C.—being an insurer for a consideration—by making good the shortages, destroyed the Bank's and the depositors' claims against Brown's life insurance—witness the following language from the *American Surety Co.* opinion (pp. 164 and 165 of 133 F. (2d)):

> "When Insurers (F.D.I.C.) paid Interior (made good the shortages in the depositors' accounts), the

right of Interior (the Bank or the depositors) to pursue its claim against Bank (the depositor against the Bank; the Bank against Brown's insurance) was destroyed as Interior (the depositors or the Bank) would not be permitted a dual recovery. Therefore, there was in existence no enforceable claim against Bank (the depositors against the Bank; the Bank against Brown's insurance) which Interior (the depositors or the Bank) could assign to Insurers (F.D.I.C.), and which would support recovery in favor of Insurers (F.D.I.C.). * * * That Oregon law follows the rule stated is evident in American Central Ins. Co. v. Weller, 106 Or. 494, 212 P. 803, where the court held, as already mentioned in connection with this case, that payment by the insurer (F.D.I.C.) on the insurance policy (12 U.S.C.A., Sec. 264 (1)) satisfied the debt involved, and concluded that the debt could not be assigned.

"Insurers (F.D.I.C.) have no right of subrogation. The assignment to them of Interior's (the depositors' claim against the Bank; the Bank's claim against Brown's insurance) cause of action against the Bank (the depositors' claim against the Bank; the Bank's claim against Brown's insurance) cannot assist them."

F.D.I.C. says if it must rely on subrogation that its rights are superior to Appellant's since she claims only through the wrongdoer (Reasons 3, 4 and 5 above). However, Appellant does not claim through the wrongdoer but under solemn contracts in which she was designated the beneficiary and it cannot be claimed that she had either actual or constructive notice of her son's wrongdoing.

The equities are in her favor as against an insurer for a consideration—witness the following statements from the *American Surety Co.* opinion (pp. 162, 163 and 164 of 133 F. (2d)):

> "The right of subrogation is a creature of equity, applicable where one person is required to pay a debt for which another is primarily responsible, and which the latter should in equity discharge. In theory one person is substituted to the claim of another, but only when the equities as between the parties preponderate in favor of the plaintiff. * * * A surety may pursue the independent right of action of the original creditor against a third person, but it must appear that said third person participated in the wrongful act involved or that he was negligent, for the right to recover from a third person is merely conditional in contrast to the right to recover from the principal which is absolute. The equities of the one asking for subrogation must be superior to those of his adversary. If the equities are equal or if the defendant has the greater equity, subrogation will not be applied to shift the loss.
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> * * *
>
> "In the instant case the surety contracts are confined to Insurers and Interior. Any right of recovery against third parties for money paid Interior by Insurers under the contracts must rest solely upon a weighing of the equities as between the third parties and Insurers. Such equities generally depend upon participation in wrongdoing, negligence, or knowledge, although we do not mean to say that these expressions cover the gamut of equities which may or should be considered.
>
> * * *
>
> "In all of the situations outlined defendants had

actual knowledge of facts sufficient to put them on notice of the wrongdoing and in a way, therefore, were implicated in the wrong done. * * * No indication is found that Bank knew any facts which would suggest the fraud of an employee of its depositor. Insurers, on the other hand, expressly contracted to secure Interior against losses caused by a dishonest employee, such as Crowe. They accepted the responsibility for such losses for a compensation, the premiums paid to them, which they have retained. Both they and Bank are innocent of any wrongdoing, although all were liable to Interior (under assumption of Bank's liability to Interior) on the basis of independent contract obligations—the implied contract of Bank to pay only to those entitled, and the contracts of Insurers to indemnify against losses caused by a defalcating employee. Since Insurers expressly, voluntarily and for a compensation guaranteed against loss in the exact situation involved, the equity in the situation cannot lie in favor of Insurers and against Bank for the payment made."

This issue was disposed of by the trial court in these words:[23]

"Finally, it is objected that no matter what were the rights of the bank, the intervenor could not succeed to them because, having assumed the deposit liability of the bank the obligation was thus satisfied. It is assumed that this objection can be based upon American Surety Company vs. Bank of California, decided by this court in an opinion reported in 44 F. Supp. 81, and affirmed by the Circuit Court of Appeals for the Ninth Circuit in an opinion reported in 133 F. (2d) 160. The confusion of plaintiff seems to arise from the fact that no account is taken of the

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[23] R. 52 and 53.

specific contract made in these two cases. The American Surety Company had there become responsible for the fidelity of the embezzler and when the proceeds of the wrongdoing were replaced, the obligation was completely satisfied. Here, the Federal Deposit Insurance Corporation was under duty simply to replace the assets, no matter how the loss occurred. It has no specific responsibility for the fidelity of Brown. When it carried out the obligation to replace the assets lost, it acquired the right of the bank against the wrongdoer. Both these cases are ruled by Oregon decisions. The American Surety Company case is governed by the opinion in the case of American Central Insurance Company vs. Weller, 106 Oregon 494. This case, on the other hand, is governed by the Jansen case above cited."

While it is perhaps unimportant, it should be noted that the trial court misstated the issue to be decided.

No one contends and it is not the fact that ***F.I.D.C.*** *"assumed the deposit liability of the bank".*

According to the admitted facts, F.D.I.C. merely replaced the shortages in the depositors' accounts.[24]

The trial court attempted to distinguish the *American Surety Co.* case on the ground that the obligation assumed by F.D.I.C. was different from that assumed by the Surety Company.

There is no distinction in the liability assumed if

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[24] R. 14.

F.D.I.C.'s obligation and what it actually did according to the admitted facts is correctly stated.

American Surety Co. agreed to make good a shortage due to an employee's infidelity. F.D.I.C. agreed to make good a shortage whether due to an employee's infidelity or merely to bad judgment. F.D.I.C.'s obligation was greater than the Surety Company's but what it was called on to do in this case was to fulfill the identical obligation which the Surety Company assumed in the *American Surety Co.* case.

Here F.D.I.C. made good the shortage due to the employee's infidelity. In the *American Surety Co.* case the Surety Company made good the shortage due to the employee's infidelity.

F. D. I. C., by so responding, can acquire no better standing than American Surety Co. did when it responded in identically the same way.

In the concluding sentences of its opinion on this point, the trial court says:[25]

> "The American Surety Company case is governed by the opinion in the case of American Central Insurance Company vs. Weller, 106 Oregon 494. This case, on the other hand, is governed by the Jansen case above cited."

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[25] R. 53.

The *Jansen* case referred to is *Jansen v. Tyler,* 151 Ore. 268, 47 P. (2d) 969, 49 P. (2d) 372, which merely holds that where an employee embezzles funds and uses them to pay life insurance premiums, the employer may claim the proceeds of the policies to the extent that embezzled funds were used to pay the premiums. The *Jansen* case is not concerned with a third party attempting, by virtue of assignment or subrogation, to assert the right of the one whose funds were stolen. It has no bearing upon the right of F.D.I.C. or of American Surety Co. to assert the right of the victim after the loss has been made good.

The *American Surety Co.* case is controlling and it must be held that F.D.I.C. has no claim to the proceeds of the policies. A judgment awarding all of the proceeds of the policies to Appellant should be entered.

SPECIFICATION OF ERROR II

THE TRIAL COURT ERRED IN FINDING AND CONCLUDING THAT F.D.I.C. WAS ENTITLED TO ANY OF THE PROCEEDS OF THE POLICIES.

(a) Since the controlling facts were stipulated, the ordinary rule that the trial court's findings will not be reviewed is without application and this court is free to reach its own conclusion untrammeled by the District Court's Findings and Conclusions.

(b) The sole question for determination is whether the premiums were paid with funds wrongfully embezzled or misappropriated from the Bank.

(c) The trial court found and concluded that embezzled funds were not traced into Brown's accounts or into the premium payments.

(d) The trial court held and it is the law that unless the stolen funds can be directly traced into the insurance premiums, there can be no recovery by or on behalf of the Bank.

(e) The moneys drawn by Brown as salary were not embezzled funds.

(f) There is no such thing as an automatic setoff which would extinguish the balances in Brown's accounts when the premium checks cleared.

(g) The burden of proving that embezzled funds went into the payment of the premiums was on F.D.I.C.

(h) Since Brown had other sources of income and the exact items of credit making up the balances in his accounts have been agreed upon, it cannot be found or concluded that the funds in his accounts were embezzled.

(i) If commingling be assumed, since Brown's own funds were more than sufficient to pay each of the premiums when the checks cleared, Appellant is entitled to prevail.

(j) The admitted facts compel the conclusion that Appellant is entitled to prevail.

ARGUMENT

(a) Since the controlling facts were stipulated, the ordinary rule that the trial court's findings will not be reviewed is without application and this court is free to reach its own conclusion untrammeled by the District Court's Findings and Conclusions.

Since the controlling facts have been agreed upon and are contained in the Pretrial Order,[26] the ordinary rule that an appellate court will accept the trial court's findings of fact, where it saw the witnesses and observed their demeanor, is without application.[27]

The facts having been stipulated, this court on this appeal is free to reach its own conclusion untrammeled by the district court's findings and conclusions.[28]

(b) The sole question for determination is whether the premiums were paid with funds wrongfully embezzled or misappropriated from the Bank.

Assuming the first Issue of Law framed in the Pretrial Order (which raises the question as to F.D.I.C.'s right to claim the proceeds of the policy as assignee or by way of subrogation) is decided against Appellant—the possibility of which assumption we expressly deny—it will then become necessary for the court to decide the remaining Issues of Law.

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26 R. 3-16.

27 British American Assur. Co. v. Bowen (C.C.A. 10th), 134 F. (2d) 256, 260.

28 Wigginton v. Order of United Commercial Travelers of America (C.C.A. 7th), 126 F. (2d) 659, 661, certiorari denied 317 U. S. 636, 87 L. ed. 513, 63 S. Ct. 28. See also Cyclopedia of Federal Procedure (2d ed.), Vol. 12, § 6211, p. 268.

The second Issue of Law is as follows:[29]

> **"Whether the various premium payments were paid with funds belonging to Edward N. Brown or with funds wrongfully embezzled or misappropriated from the Harney County National Bank of Burns, Burns, Oregon."**

This question is one of law because all of the facts with regard to the balances in Brown's accounts at the time the premium checks cleared and the items of credit making up the balances have been agreed upon.[30]

(c) The trial court found and concluded that embezzled funds were not traced into Brown's accounts or into the premium payments.

No evidence was offered and none exists to show that any of the stolen funds went into Brown's bank accounts against which the premium checks were drawn.

The trial court, in its opinion, made it clear that there is no evidence that the embezzled funds went into Brown's accounts, in the following words:[31]

> "The cardinal factor is, that no item of the embezzled funds is traced directly into the premiums of the insurance policies, nor into the bank accounts, which Brown maintained with the Harney County National Bank."

(d) The trial court held and it is the law that unless the stolen funds can be directly traced into the insurance premiums, there can be no recovery by or on behalf of the Bank.

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29 R. 26.

30 Baer v. Lorimer (Cal. 1934), 28 P. (2d) 909, 910. See also Wigginton v. Order of United Commercial Travelers (C.C.A. 7th), 126 F. (2d) 659, 661, certiorari denied 317 U. S. 636, 87 L. ed. 513, 63 S. Ct. 28.

31 R. 35.

In the trial court, we contended that before F.D.I.C. could share in the proceeds of the policies it would have to be proven that the stolen funds entered Brown's various accounts.

The law on this point is clear[32] and the trial court held correctly that the stolen funds must be traced into Brown's accounts before F.D.I.C. can prevail.

Witness this paragraph of the court's opinion:[33]

> "It is, however, established that there was a confidential relationship and a breach thereof. But according to the definition of a constructive trust, property must pass into the hands of the persons upon whom the courts impose it, or by his machinations, into the hands of third parties in order to lay a basis for recovery. There is no doubt that upon the discovery that the funds had been stolen, the bank could have recovered from Brown in some of the forms of assumpsit or debt, but UNDER THE DOCTRINES OF RESTITUTION IT COULD NOT RECOVER SPECIFIC PROPERTY FROM HIM, OR FROM A THIRD PARTY, UNLESS IT COULD BE PROVEN THAT THE FUNDS SO ABSTRACTED FROM THE BANK WERE INCLUDED THEREIN, OR WERE PART OF THE PURCHASE PRICE THEREOF. THEREFORE, UNLESS THE STOLEN FUNDS COULD BE DIRECTLY TRACED INTO SPECIFIC ARTICLES OF PROPERTY, OR INTO LIFE INSURANCE PREMIUMS, THERE COULD

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32 Picciano v. Miller (Idaho 1943), 137 P. (2d) 788, 790, 791; Bogert, Trusts and Trustees, Vol. 4, § 921, p. 2651; Restatement, Trusts, § 202; Restatement, Restitution, §§ 205, 215.

33 R. 42 and 43.

BE NO RECOVERY BY THE BANK OF THE ARTICLES OR PROCEEDS OF THE POLICIES, NOTWITHSTANDING THE IMMORAL AND ILLEGAL OPERATIONS OF BROWN AND THE GREAT LOSS CAUSED TO THE BANK THEREBY."

Since the stolen funds were not traced into Brown's bank accounts out of which the premiums were paid—and the trial court so held[34]—all of the proceeds of the policies should have been awarded to Appellant.

(e) The moneys drawn by Brown as salary were not embezzled funds.

Under the admitted facts, several premium payments on the policies were made in whole or in part with funds Brown had drawn as salary.[35]

Legal issues III, IV and V, stated in the Pretrial Order,[36] raise the question whether Appellant or F.D.I.C. is entitled to claim the benefit of the premium payments so made.

"III

"Are the items of deposit which are constituted by salary paid by the Bank to Brown and placed in his account, moneys belonging to Brown which constitute an actual credit to the account?

IV

"If Brown, at the time of drawing said salaries, was guilty of embezzlement, misappropriations, defalcations

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34 See page 20 herein.

35 R. 6-13, paragraphs X, XI, XII, XIII, XV, XVI, XVII and XVIII.

36 R. 26 and 27.

or other breach of trust in his dealings with the Bank, was he entitled to any compensation from the Bank?

V

"If it be held that Brown was not entitled to any compensation from the Bank, were the funds that he drew as compensation funds wrongfully embezzled, misappropriated or converted from the Bank?"

F.D.I.C. contended below that Brown was not entitled to draw any salary because of his infidelity.

Appellant contended and now insists that the question is not whether he was entitled to draw his salary—the fact remains that he did. The question is whether the funds so drawn were "funds wrongfully embezzled or misappropriated from the bank". If they were not—regardless of whether he was entitled to draw his salary by reason of his infidelity—Appellant is entitled to the benefit of the payments so made.

We have found no case holding that one from whom money is embezzled is entitled to claim the benefit of premium payments made with money drawn as salary.

One of the leading cases in which one from whom money was embezzled sought to invoke the remedy of following the embezzled funds into the premiums and then into the proceeds of the policy is *Truelsch v. Northwestern Mutual Life Insurance Company,* 38 A.L.R. 914, 186 Wis. 239, 202 N.W. 352.

In that case the wrongdoer's salary was paid over to his wife and she used it to run the home. The money used to pay the premiums was definitely shown to have been

embezzled and the court rightly held that the employer was entitled to enforce a trust on the proceeds of the policy to the extent that his funds could be traced into it. While the exact point with which we are here concerned is not mentioned by the court, there is a clear implication to the effect that had the premiums been paid from the employee's salary that the employer would not have been entitled to prevail.

It may be conceded that there are many cases holding that a corporate officer or agent who is guilty of embezzlement, fraud, mismanagement or gross neglect is not entitled to claim or sue for his stipulated salary.[37]

But before F.D.I.C. is entitled to the benefit of any premiums paid, it must be shown that the money used to pay them was "wrongfully embezzled or misappropriated" from the Harney County National Bank.[38]

The sums which Brown drew as salary *were drawn with the knowledge, consent and approval of the Bank.*[39]

Under no possible theory could it be held that funds so acquired were "wrongfully embezzled or misappropriated" from the Bank.

In *Sweet v. Lang* (C.C.A. 8th), 14 F. (2d) 762, it is held that a receiver acquires no interest in a policy on the life of an officer, payable to his wife or estate, the premiums on which were paid with company funds, when the corporation knew of and ratified the payments.

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37 See 5 Fletcher on Corporations, Perm. ed., § 2145, p. 462.
38 R. 26—Issue of Law II.
39 R. 15 and 16—Pretrial Order Paragraph XXII.

In *Oliver v. Northwestern Mutual Life Ins. Co.*, (D. C. Pa.), 2 F. Supp. 266, it is held that where premiums are paid with company funds drawn with the consent of the stockholders and directors that there is no breach of trust sufficient to permit a receiver to recover the premiums.

Funds drawn by Brown as salary were no more "embezzled funds" than money regularly borrowed from a bank and it has never been held that a lender can follow money borrowed to pay premiums into the proceeds of the policy.

In *Jansen v. Tyler,* 151 Ore. 268, 47 P. (2d) 969, 49 P. (2d) 372, the Oregon Supreme Court established the rule under which F.D.I.C. (if it should prove that Brown paid the premiums with funds or property embezzled, misappropriated or wrongfully converted from the Bank,) would be entitled to that proportion of the proceeds of the policies which the premiums paid with stolen funds bear to the total premiums paid.[40] In that case it was held that Tyler paid the first 3 premium payments upon the policies involved with company funds. The balance of the premium payments were held to have been made with Tyler's own funds. Tyler's embezzlements and misappropriations were at all times in a very large amount and at the time of his death he had overdrawn his salary account by at least $5,000.00. Unquestionably, some of the premium payments which were held to have been made with Tyler's own funds were paid with funds which he

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[40] R. 28—paragraph XI.

drew from his salary account, either as salary or overdraft, but they were still held to have been paid with Tyler's funds and not with the corporation's.

Clearly the salary items are not "embezzled funds" so that F.D.I.C. cannot benefit from the payments made with them.

(f) There is no such thing as an automatic setoff which would extinguish the balances in Brown's accounts when the premium checks cleared.

Since the stolen funds were not and cannot be traced into Brown's bank accounts and since the salary items are not "embezzled funds", F. D. I. C. conjured up a theory to destroy the balances in Brown's accounts when the premium checks cleared in an attempt to prevent Appellant from recovering.

F.D.I.C.'s theory (which the trial court followed) is that of automatic setoff.

Issues of Law VII and VIII are as follows:[41]

> **"Does the fact that Brown embezzled and misappropriated or wrongfully converted moneys, funds or property belonging to the Bank automatically extinguish, without a charge or set off by the Bank, any items of deposit of his own funds in any account upon which checks in payment of premiums were drawn?"**
>
> **"If it be found that Brown had embezzled, misappropriated or wrongfully converted funds or property**

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41 R. 27 and 28.

of the Bank, exceeding the amount of any items of deposit in his accounts, at or before the time of the charging of any check for premiums, whatever may have been the source of such items, is the Defendant entitled to the benefit of the premium payment so made?"

In the trial court, F.D.I.C. contended that even though it be held that Brown's salary and the other items credited to his account are "his funds", as distinguished from moneys "embezzled" from the Bank, that there never were any actual balances in any of his accounts because at all times his embezzlements exceeded any balances which might otherwise exist.

It is Appellant's contention that the balance in any or all of Brown's accounts can not be extinguished as of a long past date, by merely showing that he had at all times embezzled more than his balances.

In *American National Bank v. King,* 158 Okla. 278, 13 P. (2d) 164, King, while cashier and president of the bank, embezzled and misappropriated large sums of money—exceeding at all times the balance in his account at the bank. During the period when he was a defaulter, he took out insurance on his life in favor of his wife and family. King committed suicide and the embezzlements were discovered. Thereafter the Bank brought action to share in the proceeds of the policy to the extent that the premiums were paid from funds of the bank. It was contended that while the premiums were paid by checks drawn on King's personal account, that there never was any actual balance in his favor because at all times he had

embezzled far more than the balance shown in his account. The trial court and the Oklahoma Supreme Court refused to follow the Bank's theory (which is identical with that asserted here by F.D.I.C.) and held that the balance in King's account could not be so extinguished.

Another case which is helpful as showing that there can be no such thing as a retroactive automatic setoff is the case of *Duke v. Johnson,* 127 Wash. 601, 221 Pac. 321. In that case Johnson bought shares in the bank under an agreement with Larson that he (Larson) would repurchase them if Johnson at any time wished to return them. Johnson, while Vice President and Director of the bank, called upon Larson to repurchase the stock, which was done by the delivery to Johnson of a cashier's check which was subsequently charged by Larson to the personal account in the bank of one Lindeberg, who owned most of the stock of the bank. Shortly after the check was paid the bank was found to be insolvent and the plaintiff—the State Supervisor of Banking—took charge. The Supervisor brought action to recover from Johnson the amount of the check issued in repurchase of his stock, which was charged to Lindeberg's account, on the theory that he (Johnson) wrongfully took the bank's assets while Vice President and a Director thereof. The trial court decided against the Supervisor and he appealed. In affirming the judgment, the Supreme Court of Washington said (p. 322 of 221 Pac.):

> "The appellant further contends that the credit to Lindeberg's account as shown on the books of the bank was fictitious rather than real. This claim is

> founded on the fact that the bank then held Lindeberg's obligations for an amount possibly in excess of his checking account. *But the bank had not then attempted to exercise a right of set-off, even conceding it had such right.* It then recognized the account as a checking account, and as long as it did so, Lindeberg or his authorized agent were privileged to draw checks thereon."

Another case in point is *Peoples State Bank v. Caterpillar Tractor Co.,* 12 N.E. (2d) 123. In that case the Tractor Company sold a tractor to its dealer on a conditional sales contract and took an assignment of the purchase order which the dealer held and all moneys due under it. The dealer delivered the machine to the customer, collected the funds and deposited them in its bank account. The dealer then drew a check for a part of the amount due on the conditional sales contract in the Tractor Company's favor and the bank then set off its claim against the dealer on a past due note and dishonored the Tractor Company's demand for the funds due it on the sale of the tractor. Reversing the trial court, the Supreme Court of Indiana said (p. 126 of 12 N.E. (2d)):

> "A deposit in bank creates a relationship of creditor and debtor between the bank and the depositor, and the bank has the right at its option to set off its indebtedness to the depositor against any debt which may be due from the depositor to the bank. *But, until the bank elects to set off, any one in favor of whom checks are drawn and paid takes the funds free of any claim by the bank.* * * * The rights of the parties therefore must be determined as of the time when the appellant elected to exercise its right to set-off."

It will thus be seen that no retroactive automatic setoff can be claimed in order to avoid the effect of past completed transactions.

In the trial court, counsel for F.D.I.C. did not contend that the case of *McConnell v. Henochsberg,* 11 Tenn. Appeals 176, supported their theory of automatic setoff but it was cited to support the following proposition of law:

> "A constructive trust is created, arising *ex maleficio* out of the fraud and dishonest conduct of one who purchases for himself with the funds of another."

The trial court adopted F.D.I.C.'s theory of automatic setoff and as supporting authority placed its decision solely and squarely upon *McConnell v. Henochsberg.*

The trial court said:[42]

> "The result is, that the Tennessee case (McConnell v. Henochsberg) is the only reasoned case upon this particular set of circumstances. Inasmuch as this decision squares with correct doctrine, as indicated by the previous discussion, it will be followed upon this point. All the money paid out upon checks issued by Brown against his paper accounts, belonged to the bank."

An analysis of the *McConnell* case shows that (1) it is not in point on the facts, (2) it was decided in 1929 by an intermediate appellate court in Tennessee, (3) while

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[42] R. 49.

there have been literally thousands of cases on the subject of tracing stolen funds into insurance premiums, *it has never once been cited or followed,* and (4) it does not support the theory of automatic setoff.

In the *McConnell* case H was teller and assistant cashier in a bank in Memphis. During an examination of the bank by the State Bank Examiners a shortage was discovered. H thereafter confessed his guilt and took his life. The bank thereupon closed its doors and was taken over by the superintendent of banks. An audit revealed that H was $329,591.75 short. The auditors were able to reconstruct H's transactions so as to show his methods of withdrawals and concealment. At the time of H's death, there was in force a considerable amount of life insurance payable to his wife, son and daughter. One-third of the insurance was taken out prior to 1920 and all premium payments made prior to that date were paid with H's own funds. H maintained six accounts in the bank and all premium payments subsequent to 1920 were made from these accounts. While H's salary was $300.00 to $350.00 per month (which he deposited in these six accounts) in the seven years following 1920 he ran through his accounts over $116,000.00. *A very considerable part of the deposits entering H's accounts were made from funds stolen from the bank.* While H had outside enterprises, all were unprofitable except one on which he made approximately $1,000.00. By his own confession H lost large sums in gambling over a period of years. *The auditors, by an analysis of H's six bank accounts, demonstrated that all*

premiums paid on the life insurance policies subsequent to 1920 were made out of funds embezzled from the bank. H had sources other than his salary and funds stolen from the bank "but the amounts received from these sources are insignificant".

Upon this evidence, the trial court held that the superintendent of banks was entitled to all the proceeds realized from the insurance upon H's life which was taken out subsequent to 1920 and to a proportionate part of the funds paid upon the policies taken out before 1920 in the ratio that the premiums paid subsequent to 1920 bore to those paid by H prior to 1920.

The beneficiaries appealed, contending (1) no precedent in Tennessee warranted the imposition of a constructive trust upon the proceeds of insurance policies, the premiums on which were paid wholly or partly with embezzled funds, (2) the beneficiaries acquired a vested property right in the policies upon payment of the initial premiums, (3) the imposition of a constructive trust never follows the mere showing of misappropriations, (4) trust funds could not be held to reappear in H's accounts when new deposits were made after complete exhaustion thereof, (5) the burden was on the superintendent of banks to clearly and definitely trace the trust funds into and out of H's accounts and into the premiums paid, and (6) since other funds were available for payment of premiums there was no presumption that they were paid out of embezzled funds.

Points 1 and 2 were disposed of by following cases from other jurisdictions, among them *Truelsch v. North-*

western Mutual Life Insurance Company[43] and *Vorlander v. Keyes,*[44] which establish the rule which is conceded in this case.[45]

Points 3, 4 and 5 are disposed of by the court in the following language:

> "* * *, *no constructive trust can be impressed upon property unless the misappropriated fund is traced into the property sought to be impressed with the trust.*
>
> "It is urgently insisted in this case by appellants that the complainant has failed to show by satisfactory or sufficient evidence that any part of the funds stolen by Henochsberg from the bank went into any of the property, the life insurance involved, the Hein Park property, and the other property involved in this case, and that without a sufficient tracing of the misappropriated or stolen funds into this property that there can be no constructive trust in favor of the bank.
>
> "There can be no question, but that the stolen funds must be traced into the property sought to be impressed with the constructive trust. This principle has been recognized by the courts and textwriters with practical unanimity.
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> * * *
>
> "Appellee concedes that the rule is as above stated, but insists that complainant has shown by proof that the property sought to be impressed with a constructive trust in this case, including the insurance premiums, was purchased with funds stolen from the bank, and *that the stolen funds have been definitely traced into the payment of the insurance pre-*

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43 38 A.L.R. 914, 186 Wis. 239, 202 N.W. 352.

44 1 F. (2d) 67.

45 R. 28 and 29—Pretrial Order Paragraph XI.

miums and the purchase of the other property, except insurance premiums paid on the policies issued prior to January 1, 1920.

"* * * *Not all of this money so stolen by Henochsberg was passed through his various bank accounts, but it is evident that several thousand dollars of this stolen money was used by Henochsberg and did actually pass through his bank accounts in the American Savings Bank & Trust Company.* His salary during this period, a part of the time, was $300 per month, and a part of the time $350 per month, and while he had some other business connections during this period, *it is clearly apparent from the record that his earnings from such sources were comparatively insignificant.* His bank accounts showed deposits several times larger than any source of income that he had during this period. *The checks drawn by Henochsberg and his wife on his accounts at the bank exceeded greatly any legitimate deposits made by him to these accounts.* It is true that at no time during this period did his bank accounts reflect any considerable balance to his credit, and it is also true that on certain dates approximating the dates on which checks were given for insurance premiums, that his bank accounts would show small overdrafts. *It would appear,* and we think with sufficient definiteness, *that Henochsberg employed a system of feeding into his bank accounts stolen moneys from the bank, from time to time, a sufficient amount to have his accounts show only small balances on any given date to his credit,* and that this was one of the methods employed by him to deceive the bank officials, or to prevent suspicion. *But it is clearly apparent* from the record *that checks issued by him in payment of the life insurance premiums* after January 1, 1920, and in payment of the other investments, and payments on the other property sought to be impressed with a trust herein,

were paid out of moneys which did not belong to him, and that he had so mingled the stolen moneys with his own funds in the bank accounts as to make it impossible to actually ear-mark the stolen moneys as having been used exclusively in paying the life insurance premiums and the payments on the other property involved."

The climax of the Court's holding is expressed in the following paragraph on pages 197 and 198 of the opinion:

"While recognizing the settled rule that the misappropriated funds must be traced into the specific property before there can be a constructive trust impressed, we are of the opinion that where the trustee ex maleficio has pursued a systematic scheme and plan of stealing funds from the bank, where he sustains the fiduciary relation of assistant cashier and has direct supervision of the accounting department of the bank and abuses the confidence of the employers of the bank, and by the method employed uses the stolen funds taken by him from the deposits of customers, and *at such times as it becomes necessary and expedient feeds a sufficient amount of the stolen funds into his own bank account to protect checks drawn by him on his accounts in the payment of life insurance premiums* and payments on the other property sought to be impressed with the trust, that it constitutes such a tracing of the stolen funds into this property as to meet the exactions of the law with reference to impressing such property with a constructive trust."

The distinction between the case at bar and *McConnell v. Henochsberg* is clear and unmistakable.

First, The funds which H embezzled were definitely traced into the accounts from which the premiums were paid. *Second,* H had no funds of his own from which the premiums could have been paid.

Here (a) there has been a complete failure to prove that *any* embezzled funds went into the accounts from which the premiums were paid, (b) Brown had ample funds of his own from which to pay the premiums,[46] and (c) *the exact items credited to his accounts, when the checks in payment of premiums were cleared, have been agreed upon, and it is not even claimed that any of them are "embezzled funds".* In any event, at all times there was sufficient of Brown's own funds in the accounts to pay the premium checks.

If it were the fact (and it is not) that Brown placed "embezzled funds" in his accounts, we may rest assured that F.D.I.C.'s auditors would have compiled and there would have been introduced in evidence a chart or summary tracing the amounts withheld from depositors' accounts into his bank accounts.

That this is not the fact is best established by the Agreed Facts which show the various credits to Brown's accounts when the premium checks cleared. In every instance[47] the credits to his accounts are either salary or amounts received by him from outside sources. In not one

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[46] R. 19-24.
[47] R. 6-14—paragraphs X to XIX.

single instance is it claimed that any credit is either "embezzled funds" or the proceeds of embezzled funds.

Obviously, *McConnell v. Henochsberg* is not in point. The proof which was relied upon by the court in finding that Henochsberg paid the premiums with embezzled funds was positive and convincing. Here there is a total absence of proof that *any* "embezzled funds" went into Brown's accounts. The facts agreed upon in the Pretrial Order with respect to the items of credit in the accounts when the premium checks cleared repel and make impossible a finding or conclusion that the accounts then contained "embezzled funds".

(g) The burden of proving that embezzled funds went into the payment of the premiums was on F.D.I.C.

Issues of Law VI and IX[48] present the question of "Burden of Proof".

"VI

"Must the Federal Deposit Insurance Corporation show that any particular item of deposit in Brown's account was embezzled or the proceeds of embezzled funds or property before it is entitled to the benefit of any particular premium payment or is it entitled to the benefit of any and all premium payments unless Plaintiff shows that any particular items deposited in Brown's account in fact belonged to Brown and were not embezzled from the Bank or the proceeds of embezzled funds?"

"IX

"If no evidence appears as to the source of funds

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48 R. 27 and 28.

used in payment of the last premium, who is entitled to the benefit of that premium payment?"

Appellant contends that the burden of proving that the premiums were paid with money "embezzled or wrongfully misappropriated" from the Bank is on the F.D.I.C. throughout the case.

Appellant further contends that under Oregon law, which governs this case, the proof that embezzled funds went into Brown's accounts and from them into the premium payments must be strong, clear, convincing and indubitable.

The trial court's own declaration[49] that the proof failed to show that any of the stolen funds found their way into Brown's accounts or into the premiums should end the case.

F.D.I.C.'s theory, as it was expressed in the trial court, was that since under the stipulated evidence it can be taken as admitted that Brown did embezzle sums exceeding the balances in his accounts, F.D.I.C. is entitled to the benefit of all premium payments because Appellant has not shown that the funds in his accounts were not embezzled or wrongfully appropriated from the Bank.

In other words, F.D.I.C. says it is entitled to the benefit of all payments, in view of the defalcations of Brown, unless the innocent beneficiary can establish to the court's

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[49] R. 35 and see page 20 herein.

satisfaction that her son's own individual funds and not embezzled funds were used to pay the premiums.

A mere statement of the rule contended for by F.D.I.C. brands it as foreign to our conception of fairness and justice.

One might as well contend that an accused criminal is presumed guilty until proven innocent.

We believe the law to be that Appellant is entitled to the proceeds of the policies in which she was designated beneficiary irrespective of the source of the funds which were used to pay the premiums—save only the exception that she may be deprived of the proceeds if her son embezzled or stole the money which he used to pay the premiums. One who claims that the premiums were paid with money embezzled or stolen from him must prove it. His proof need not be conclusive. It need not be direct but may be circumstantial. But it must be satisfactory and sufficient to satisfy one with an open mind of the probability that stolen or embezzled funds were actually used to pay the premiums.

All the texts and cases we have been able to find support Appellant's view on this question.

In 65 C.J. 1055, Trusts, § 985, it is said:

> "In an action to follow trust property and to enforce the trust thereon, the burden of proof in the first instance is on the cestui que trust to trace and identify his property either in its original or substituted form. Similarly, where the beneficiary claims that trust

moneys have become mingled with other funds by the trustee, he has the onus of tracing such moneys into the funds. No presumption arises that a payment for property by a trustee was made with trust funds. * * * There is no presumption that trust moneys in the hands of a fiduciary for many years and undisposed of are a part of his estate."

As is said in Scott on Trusts, Vol. III, § 508.4, at p. 2445, n. 7:

"The claimant seeking to follow his money into the proceeds and to enforce a constructive trust or equitable lien has the burden of proving that his money was in fact used in the payment of premiums upon the policy."

The following appears in Bogert, Trusts and Trustees, Vol. 4, § 921, pp. 2653-6:

"Most American courts have recognized this elementary conception with regard to the remedy of tracing, and have insisted that the cestui or successor trustee who is seeking to follow trust funds should convince the court that the bonds, bank accounts, stock, realty, or other property, which the complainant desires to take from the hands of a defaulting trustee or another not a bona fide purchaser, either is part or all of the original trust property, or is property which has been produced by the original trust res through sale, barter, reinvestment, or some other process.

"This majority view denies the remedy of tracing where the proof of the cestui claimant merely shows

> the receipt of trust property by the defendant and makes no case as to its subsequent history or its existence among the present assets of the defendant, and also where the evidence shows that the trust property has been disposed of in such a way as to leave no product."

Not only is the burden of proof upon F.D.I.C. but the proof offered must be strong, clear, convincing and indubitable.

In *Barger v. Barger,* 30 Ore. 268, 47 Pac. 702, the Supreme Court of Oregon said (at page 275 of 30 Ore.):

> "It may be stated, also, as a settled principle of law, that in order to establish a resulting trust the evidence must be strong, clear, convincing, and indubitable, touching the fact of payment by the alleged beneficiary, or for or in his behalf: 2 Pomeroy's Equity Jurisprudence, § 1040; *Sisemore v. Pelton,* 17 Or. 546 (21 Pac. 667); *Lee v. Browder,* 51 Ala. 288; *Westerfield v. Kimmer,* 82 Ind. 369; *Murphy v. Hanscome,* 76 Iowa 192, (40 N.W. 717). And when a payment of a part only is claimed, it must be shown in the same clear, concise, and unequivocal manner, the exact proportion of the whole price actually paid, and that the payment was made for some specific part or distinct interest in the estate: 2 Pomeroy's Equity Jurisprudence, § 1040; *Cutler v. Tuttle,* 19 N.J. Eq. 561; *Olcott v. Bynum,* 84 U.S. (17 Wall.) 59; *Baker v. Vining,* 30 Me. 127 (1 Am. Dec. 617); Browne on the Statute of Frauds, § 86. So it is, also, as respects constructive trusts—the evidence that the purchase was made with trust funds must be clear

and unmistakable: 2 Pomeroy's Equity Jurisprudence, § 1049."

The same rule has been stated in different terms in more recent Oregon decisions.[50]

(h) Since Brown had other sources of income and the exact items of credit making up the balances in his accounts have been agreed upon, it cannot be found or concluded that the funds in his accounts were embezzled.

As an alternative theory (in addition to automatic setoff) to support the judgment in favor of F.D.I.C., the trial court held that in the complete absence of any evidence that stolen funds got into Brown's accounts it could be inferred that they were in his accounts since when Brown started with the Bank in 1927 he had no other source of income but salary and stolen funds.

The exact language of the court is as follows:[51]

> "There is an alternative and equally convincing theory upon which the same conclusion may be founded. A review of the evidence which, although indirect, is convincing, makes clear that since Brown had no other sources of income initially, except his salary and the embezzled funds, that the bulk of the moneys which he deposited was from these springs. *None of the stolen money can be traced directly*

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50 Schwartz v. Gerhardt, 44 Ore. 425, 432, 75 Pac. 698; Smith v. Barnes, 129 Ore. 138, 147, 276 Pac. 1086.

51 R. 49 and 50.

thereto, but any fact may be proven by direct or indirect evidence. This leads to a consideration of an analogous line of cases where the defaulter is not an employee of a bank but deposits the stolen funds therein. It will be apparent that the doctrine just held controlling would not apply under such circumstances (automatic setoff). However, the courts reach the same result on the ground that once fraud has been proven, the doctrine of comingling of funds applies[18] and the constructive trustee will be liable if he does not segregate the fund. Since there is no presumption of innocence attaching, his death will not protect the beneficiaries.[19]

* * *

"Thus it is, that all the moneys paid out by the bank belong to it.

"18 Massachusetts Bonding & Insurance Co. vs. Josselyn, 224 Michigan 159; Moseley vs. Fikes, 133 Texas 386; Long vs. Earle, 277 Michigan 505; Meyers vs. Baylor University, 6 S.W. (2d) 393, 394.

"19 See Meyers vs. Baylor University, supra."

If there were no evidence in the case as to the exact items of deposit in Brown's accounts when the premium checks cleared and if it were the fact that Brown had no funds of his own and no other source of income except stolen funds when the premium payments were made, a finding and conclusion that stolen funds were used to pay the premiums might be justified.

In this case, however, the exact items of deposit in his accounts, when the premium checks cleared, were agreed upon. F.D.I.C. does not contend that one single deposit item represents stolen funds—and the court held:[52]

> "The cardinal factor is, that no item of the embezzled funds is traced directly into the premiums of the insurance policies, nor into the bank accounts, which Brown maintained with the Harney County National Bank."

In addition, Brown's other sources of income were substantial during the time the premium payments were being made and he had funds to start with *other* than his salary and embezzled funds. The facts in this regard have also been agreed upon[53] and cannot be ignored.

When analyzed, the trial court's alternative theory[54] is that, since Brown stole money from the Bank, everything he owned can be presumed to have been acquired with stolen funds.

In other words, the court has placed the burden of proving that stolen money was not used to pay the premiums on Appellant.

The trial court cites 4 cases to sustain its holding in this regard. An analysis of them shows that they do not support the trial court's theory.

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52 R. 35.

53 R. 19-24—paragraphs A to H.

54 See page 42 herein.

Mass. Bonding & Ins. Co. v. Josselyn, 224 Mich. 159, 194 N.W. 548.

In this case an attorney was appointed administrator of two estates and he put the funds in his own account and paid premiums on existing policies on his life. After his death, the estates were permitted to share in the proceeds of the policies in the proportion that estate moneys were used. The Court said:

> "It clearly appears from (the attorney's) bank account that the balances on deposit at the time the several checks for premiums were paid were less than the amount of the moneys of the estates which had been theretofore deposited and not withdrawn."

It is apparent from the opinion that had the attorney's account contained more than enough of his own money to pay the premium payments at the time the premium checks were cleared that the estates would not have been permitted to share in the proceeds. This is the rule for which we contend in this case (which is discussed under the next heading) and if this case be followed, Appellant and not F.D.I.C. is entitled to prevail.

Mosely v. Fikes, (Texas Civil Appeals, 1939), 126 S.W. (2d) 589 (erroneously cited by the court as 133 Texas 386).

In this case, Plaintiff sued Defendant to impress a trust upon certain lands purchased with the proceeds of lands held for plaintiff by defendant, which defendant agreed to reconvey. The defendant admitted that he put

the proceeds of the sale of the lands in accounts containing his own funds and it was held:

> "Although defendant further testified that he had money of his own acquired from other sources, with which he paid for all those investments, we believe the court erred in the ruling noted, under the general doctrine relating to commingling of trust funds by a trustee with his own, and the adverse presumption that may be indulged from his refusal to answer questions propounded by plaintiff's attorney, under circumstances such as appear here."

The case is clearly distinguishable because the trustee who comingled the funds was alive and under such circumstances it can be admitted that the burden is upon the trustee to separate the fund. In this case not one cent of stolen money is traced into any of Brown's bank accounts, hence there is no commingling.

Long v. Earle, 227 Mich. 505, 269 N. W. 577.

This case involves a suit by beneficiaries to establish a trust upon property purchased with the proceeds of a trust fund. The trust was admitted and the court cited and relied upon 65 C.J. 973 to the effect that if there is comingling the whole fund is subject to the trust except insofar as the trustee may be able to distinguish and separate his own funds. Here again the trustee was alive, which distinguishes the case from the present case and a rule, which is not applicable here because of Brown's death, was correctly applied.

Meyers v. Baylor University, 6 S.W. (2d) 393.

This case involved a suit by Baylor University against Meyers and his wife to recover title and possession of real and personal property. It was claimed and found that Meyers embezzled Baylor's funds and invested them. Meyers contended that the burden was on Baylor University to trace the embezzled funds into the property shown to be embezzled and that not sufficient proof was offered. The court said on page 394:

> "Our courts have often said that, in order to establish a trust, such as is attempted in this case, the trust fund must be clearly traced into the specific property; that nothing must be left to conjective, and that no presumptions, except the usual and necessary deductions from facts proven, can be indulged * * *; yet this does not mean that the trust must be established beyond a reasonable doubt.
>
> "It is quite true that the burden of proof was upon plaintiff to establish the trust, but, where proof of the fiduciary relationship of the parties was made, the betrayal of the trust and the probable amount of the embezzlement shown, a prima facie case was presented, and the burden was then on Meyers to show, if he could, that his money, and not that of plaintiff, paid for the properties in whole or in part.
>
> "Meyers was in possession of the exact facts, and it was his duty to reveal the entire trust. As he did not testify, and made no explanation of this matter, every intendment is against him.
>
> * * *
>
> "As stated in our conclusions, Meyers deposited his own (salary) and money embezzled from plaintiff to his personal credit in the banks, thus destroying the identity of these funds; hence the whole mingled

fund became subject to the trust, as well as the property purchased therewith.

* * *

"An audit of the accounts kept by him with 3 banks showed that, * * * he deposited to his personal accounts the gross sum of \$81,589.22, of which \$32,975 was his salary. He furnished, at the request of officials of plaintiff, a statement showing that all moneys of whatever nature or origin, other than salary, deposited in these accounts, amounted to the sum of \$23,325.16. He thereupon admitted that the sum of these items, to-wit, salary and other moneys deposited shown in statement, subtracted from the total deposits in the banks, revealed the total amount of his embezzlements, which, by this method, were shown to be in excess of \$25,000. The items sought to be charged represented a total investment of \$21,200.

"* * * it appeared from the evidence that he had no other money or property with which to make the investments."

This case merely analyzes and follows the rule that where there is commingling and the trustee is alive that he has the burden of separating the funds, failing which the beneficiaries have a lien on the entire fund.

It is interesting to note that the court considers the salary which Meyers had drawn to be "his funds" as distinguished from "embezzled funds", which is our contention here, as against the position contended for by F.D.I.C.[55]

Since Brown is dead, the rule which requires a trustee

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55 See page 22 herein.

to separate the fund, where a commingling is involved, has no application.

The case of *Logan v. Logan,* 138 Texas 40, 156 S.W. (2d) 507, relied upon by F.D.I.C., to place the burden upon Appellant in this action and cited and relied upon by the trial court in its opinion,[56] best demonstrates the inapplicability of the rule contended for. In that case, the court recognized the rule that where a trustee commingles trust funds with his own private funds and the proof necessary to distinguish the funds lies exclusively within the trustee's possession and he refuses to make a disclosure of such facts as he has at his command, that a presumption arises that all funds or property purchased therewith are subject to the trust.

The Court expressly holds, however, that if the trustee is dead that no such presumption exists or can be indulged in. The Court said on page 511 of 156 S.W. (2d):

> "The trustee is dead, and consequently there is no willful failure to make a disclosure on his part. * * * Under these circumstances, the rule applicable to a wrongful commingling is inapplicable."

A very recent case, decided by the Supreme Court of Idaho, is particularly applicable. It is the case of *Picciano v. Miller.*[57]

In that case, plaintiff contended that defendant had

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56 R. 38.

57 Originally decided Sept. 15, 1942; reversed on rehearing May 21, 1943. 137 P. (2d) 788.

unlawfully appropriated, out of their business, some six thousand dollars. Plaintiff sought to prove that the stolen money was used by defendant to purchase a home. The lower court found for plaintiff and defendant appealed. The original opinion affirming the case was reversed after a rehearing.

In the final opinion, the Court said (from 790 and 791 of 137 P. (2d)):

> "There is nothing in the record to show from where Miller received the money for the purchase and improvement of the property involved. Therefore, no part of the trust fund was traced into this particular piece of property. The conclusion that the money was traced into the property is evidently based on inference, that inference being that as Miller bought the property and it did not appear he purchased it with funds he had acquired otherwise, it would therefore follow that he used the trust money for that purpose. In matters of this kind, no presumption whatever can be indulged in by the courts. The rule is announced in Pomeroy's Equity Jurisprudence, Volume 2, Section 422, page 184, as follows: 'A court of equity, in order to raise a resulting trust, will not assume from the mere fact that the purchaser had or might have had trust moneys in his hands, that he used them in paying for the property purchased, in the absence of evidence clearly showing such use by him.'
>
> "The question of the sufficiency of identification of a trust fund is discussed in 26 R.C.L., Section 219, page 1355, wherein it is stated: 'As to what is a sufficient identification of a trust fund when it is attempted to show that it remains a constituent part of the assets of an insolvent trustee's estate, it was at one time held by the courts of some of the states to be unnecessary

that the misapplied trust funds or proceeds of the trust property should have actually come into the possession of the executor, administrator, receiver, or assignee; not essential that it should be traced into the estate; * * * Most if not all of these cases have, however, been overruled or greatly limited and qualified and the generally accepted rule at the present time is that it must appear that the trust property or its proceeds have found their way directly into the estate of the trustee, that the property must be found to reside in the assets at the time when the claim is asserted, and must not have been expended or dissipated for any purpose in the business of the trustee.' See also 26 R.C.L., Section 218, page 1354.

"The rule applicable to the facts in this case is clearly stated in Jones on Liens, 3rd Ed., Volume 2, page 172, Section 1179, as follows: 'Trust funds which have been misapplied by the trustee to the purchase of lands in his own name may be declared a lien upon such lands; but it must be clearly proved that the trust funds were invested in the lands. It is not sufficient to show that the trustee was in possession of the funds, and while in possession of them he purchased and paid for the lands; *for in such case no presumption arises that the lands were purchased with such funds.* If the trust money has been mingled with other moneys of the trustee so as to be indistinguishable, and the trustee has made investments generally with the moneys in his possession the cestui que trust cannot claim a specific lien upon the property or funds constituting the investments.' (Italics mine.)

"What appears to be a leading case on this question, the same being cited in the several texts above referred to, is the old case of *Ferris v. Van Vechten,* 73 N.Y., beginning page 113, decided in 1878, and we quote therefrom a portion of the opinion, beginning page 119, as follows, to-wit: 'To follow money into

lands, and impress the latter with the trust, the money must be distinctly traced and clearly proved to have been invested in the lands. While money, as such, has no ear-mark by which, when once mingled in mass, it can be traced, it is, nevertheless, capable under some circumstances of being followed to, and identified with, the property into which it has been converted; but the conversion of the trust money specifically, as distinguished from other money of the trustee, * * * must be clearly shown. It does not suffice to show the possession of the trust funds by the trustee, and the purchase by him of property—that is, payment for property generally by the trustee does not authorize the presumption that the purchase was made with trust funds. The product of, or substitute for the original trust fund follows the nature of the fund as long as it can be ascertained to be such; and if a trustee purchase lands with trust money, a court of equity will charge them with a resulting trust for the person beneficially interested. But it must be clear that the lands have been paid for out of the trust money.'

* * *

"Had there been a tracing of any part of the trust money into the property in this case, then, of course, the rule from Waddell v. Waddell, 36 Utah 435, 104 P. 743, quoted in the original opinion, would have been applicable. That rule is not in conflict with the rule placing the burden on one who would impress property with a trust to show that some portion, at least, of the trust funds went into the property. Had that been done in this case, then the burden would have been upon appellant Miller to have shown that his own money or at least some portion thereof, had gone into the trust property, but due to the failure of respondent to trace any portion whatever of the so-called trust fund into the property, no such burden shifted to or was placed upon appellant Miller."

The trial court's alternative theory does not square with the Agreed Facts, with the applicable law establishing the burden of proof or prescribing the degree of proof required and it erroneously assumes the existence of a presumption that stolen funds got into Brown's accounts, *even in the face of its own direct finding that stolen funds were not traced into the accounts.*

(i) If commingling be assumed, since Brown's own funds were more than sufficient to pay each of the premiums when the checks cleared, Appellant is entitled to prevail.

Assuming that there is some evidence upon which a finding could be based that Brown placed depositors' funds in his accounts prior to the time the various premium payments were charged against his accounts (we deny that there is any such evidence in the case and the trial court held with us[58]), then Issues of Law X and the last two paragraphs of XI[59] must be decided.

"X

"If the total of the deposits in any account at any time is composed of Brown's own funds and funds of the Bank, who is entitled to the benefit of the premium payment made from said account if the premium payment be less than the amount of his own funds; if it be more than his own funds?

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58 R. 35.

59 R. 28 and 29.

XI

* * *

"The Defendant contends that if in any case Brown had a balance in his account made up in part of funds or property misappropriated, embezzled or wrongfully converted from the Bank and part from other funds, Defendant is entitled to the benefit of the whole premium payment thus paid.

"Plaintiff disputes this and contends that as a matter of law Brown would be held to have withdrawn from a mixed fund, first, his own funds, and if his own funds were sufficient to pay the whole premium payment that the Bank would not be entitled to any benefit from that payment."

It is Appellant's contention that if embezzled money is found to have been deposited in the accounts from which premiums were paid so that Brown's own funds and embezzled funds were mixed together, that even so Brown would still be held to have drawn out his own funds in paying the premiums and if his account contained enough to pay the premium payment that F.D.I.C. would have no claim on the payment so made. If the premium payment exceeds the amount of Brown's own funds then in the account, then F.D.I.C. would share in the premium payment to the extent of any required balance.

A leading case upon this point is *Bromley v. Railway Company,* 103 Wis. 562, 79 N.W. 741. In that case Bromley was an agent of the Railway Company and he, from time to time, collected large sums of money which he was under obligation to immediately remit to the Company. Bromley had one bank account in which he kept money of

his own, some of his wife's and into which he placed money collected for the Railroad. At a time when he was badly in arrears in his remittances to the Railroad he purchased several life insurance policies in favor of his wife. After his death, which occurred shortly after the taking out of the policies, the railroads claimed that they were entitled to the proceeds of the policies because the premiums were paid with funds belonging to the railroads.

In rejecting the Railroads' contention, the Court said on page 743:

> "Assuming that Mr. Bromley received and deposited the moneys of the defendants (Railroads) and the plaintiff (his wife), in a fiduciary capacity, and that in drawing moneys from the bank on checks for his own private use he is presumed to have drawn out his own moneys in preference to any of such trust funds, yet it does not follow that, in paying such premiums on such insurance by checks for the benefit of his wife, he is presumed to have drawn the moneys belonging to the defendants, instead of the moneys belonging to his wife. On the contrary, and as the law presumes innocence instead of wrong, we would naturally suppose that he would pay such premiums from his wife's moneys, instead of moneys belonging to the defendants; in other words, all checks drawn for the benefit of the defendants would naturally be supposed to have been drawn on funds belonging to the defendants, and all checks drawn for the benefit of the plaintiff would naturally be supposed to have been drawn on funds belonging to the plaintiff. Of course, this is on the supposition that Mr. Bromley had on deposit the funds of both parties. The court finds that Mr. Bromley received and deposited to his credit in the bank from the plaintiff's separate estate \$700 in 1894, \$400 in 1895, and in addition he received from

> her to pay premiums on life insurance $100 in the latter part of 1896. There is no evidence that he ever drew out any of such moneys so deposited for the plaintiff, or for her benefit, except in payment of the premiums mentioned."

On the same page, it is also said:

> "* * * Since the insurance was for the benefit of the plaintiff, and payable to her, Mr. Bromley would be quite as likely to pay the premium thereon out of her moneys in the bank to his credit as out of the moneys of the defendants. The relations between Mr. Bromley and the defendants appear to have been of mutual confidence, and more like the relation of debtor and creditor than that of trustee and cestui que trust. The burden was on the defendants to prove that their money went into the policies."

There is a direct holding upon the point by the Supreme Court of Oregon.

In *Portland Building Co. v. State Bank of Portland*, 110 Ore. 61, 222 Pac. 740, the Bank was obligated to pick up and pay the coupons and bonds of the Building Company, using funds specially deposited with it for that purpose. Although carried as trust funds, the moneys so entrusted to the bank were not segregated from but were mixed with other moneys belonging to the bank. Before the Bank paid any bonds or coupons, it became insolvent and there was in the fund into which the trust fund had been placed more than the amount of the trust funds. The Building Company contended that its money was still

there and had not been dissipated. The court upheld this contention, saying on page 67 (of 110 Ore.):

> "The fact that the cash balances of the bank were constantly changing as new deposits were made and checks were paid cannot affect the rights of the cestui que trust to reclaim its money, either from the bank or the superintendent of banks, as the amount of the trust fund was at all times clearly ascertainable, and that amount was at all times actually in the bank. *The presumption of law is that, in paying checks drawn upon the bank and its other expenses, the bank used its own funds then in the bank, as it was its duty to do, and did not wrongfully use the trust funds in its possession* * * *."

(j) The admitted facts compel the conclusion that Appellant is entitled to prevail.

Applying the principles which we believe to be applicable to paragraphs IX to XIX, inclusive, of the admitted facts,[60] we reach the following results:

IX. Since no one knows the source of the funds used to pay the payment of December 22, 1940, upon Policy 12748022 (hereafter called the first policy), Appellant gets the benefit of the payment.

X. Since the first payment on the first policy was made from Brown's personal account at a time when it was composed of salary and cash items and there is no evidence to show that the cash deposit was either embezzled money or the proceeds of embezzled funds, Appellant must be given the benefit of the payment. Even if it be

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60 R. 6-14.

held that the cash were embezzled funds, since the salary items exceed the premium payment (which was less than $300.00), it must be presumed that Brown drew first his own funds, especially where it was admittedly drawn for his own purpose.

XI. The second payment on the first policy was made from Brown's special account. Under the Agreed Facts, it is established that the account contained genuine items of credit, payable to Brown personally, as follows:

American Aircraft	$ 250.00
Transfer from Personal Account.......	36.12
Transfer from Personal Account.......	145.48
Blyth & Co.	1,009.40
Checks	242.85

The premium payment was less than $300.00, so that Appellant must be given the benefit of this payment.

XII. The third payment on the first policy was drawn on the personal account and it was then composed only of salary items. The benefit of this payment must therefore be awarded to Appellant.

XIII. The fourth payment on the first policy was drawn on the personal account when it contained salary and a transfer from Brown's grain account. There is no showing that the grain account contained embezzled funds or the proceeds of embezzled funds, so Appellant must get the benefit of this payment.

XIV. The fifth payment on the first policy was drawn against the special account and since there is no evidence tracing embezzled funds into that account, Appellant is entitled to the benefit of it. In any event, there is

an item of credit to the account "Kidwell and Caswell $406.90" which is more than sufficient to pay the premium, so it must be awarded to Appellant.

XV. The first payment on the second policy was drawn on the special account and there is no evidence to show that embezzled funds were deposited in it, so Appellant must be given the benefit of this payment.

XVI. The second payment on the second policy was charged against the special account when it contained the same items against which the second payment on the first policy was drawn except it contained in addition a dividend on stock Brown owned in the Harney County Bank and a transfer from his personal account which was then made up only of salary items. Clearly this payment must be awarded to Appellant.

XVII. The third payment on the second policy was charged against the personal account when it contained the proceeds of the sale of a bond Brown owned, salary and currency. The salary and bond items are more than sufficient to cover the payment, so Appellant is entitled to the benefit of it.

XVIII. The fourth payment on the second policy was drawn on the personal account and came entirely from salary. Appellant should have the benefit of it.

XIX. The fifth payment on the second policy was made from the proceeds of the sale of cattle. No evidence was produced to show that the cattle were not Brown's or were purchased with funds embezzled from depositors. Obviously, Appellant is entitled to the benefit of this premium payment.

SPECIFICATION OF ERROR III

THE TRIAL COURT ABUSED ITS DISCRETION IN DENYING APPELLANT'S MOTION FOR NEW TRIAL.

Since it was made to appear that an audit of the Bank's records disclosed that Brown was not indebted to the Bank in the years when the various premium payments were made, so that the whole basis of the court's holding against Appellant was incorrect, the trial court abused its discretion in not ordering a new trial.

ARGUMENT

Prior to the pretrial conference, which resulted in the Pretrial Order, Appellant had not made an audit of the Bank's records. At the conference, F.D.I.C. represented that its audit indicated that by reason of withheld deposits alone Brown had taken from depositors' accounts the following amounts in the years indicated:[61]

Year	Net Shortage
Prior to 1935	$ 5,869.25
1935	12,893.21
1936	3,031.52
1937	17,996.84
1938	40,982.14
1939	93,203.44
1940	39,780.33
1941	489.99
1942	10,319.61

61 R. 79. Exhibit 34.

The trial court used these figures as the basis for its holding that at no time did the total in Brown's accounts equal the sum of his defalcations from commercial accounts alone.[62] No attempt was made by F.D.I.C. to break down by years any other source of alleged shortages.

In connection with an action pending in the District Court by F.D.I.C. against Edward N. Brown's Estate, an audit was made of the Bank's records in May and June of 1944. The audit was in progress when the court's opinion was announced and it was completed shortly thereafter.

According to the auditor for the Estate, it appeared probable that Brown was not, in fact, indebted to the Bank by reason of alleged embezzlements during the years 1935, 1936, 1937, 1938, and perhaps in the subsequent years, except 1942. The auditor also discovered that many of the so-called withheld deposits were actually reflected on the Bank's record so that the funds were actually received by and went through the Bank.

As soon as these findings were reported to Appellant, an appropriate Motion for New Trial was filed in which these facts were made to appear.[63]

Counsel for F.D.I.C. filed an affidavit in opposition to the Motion, in which he attempted to explain the so-called withheld deposits—but it is apparent from his explanation that, in fact, the withheld deposits actually were recorded in the daily savings journal or ledger so that

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62 R. 33.
63 R. 68-71.

the funds of necessity were received by and passed through the Bank.[64]

Since the result would be entirely different and Appellant would be entitled to prevail even under the trial court's decision, if she were permitted to present the true facts, we contend that the trial court abused its discretion in refusing to grant a new trial.

CONCLUSION

The case of *American Surety Co. v. Bank of California* has not and cannot be distinguished. F.D.I.C.'s claim to the fund must therefore be denied.

In view of the Agreed Facts, it cannot be found or concluded the embezzled funds were used to pay the premiums.

In any event, the trial court committed reversible error in refusing to grant a new trial.

Respectfully submitted,

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[64] R. 75 and 76.